

Research Update:

Spanish City of Barcelona 'A' Rating Affirmed; Outlook Still Negative

July 23, 2021

Overview

- Despite the suspension of deficit targets and expenditure pressures arising from COVID-19, the city of Barcelona's performance in 2020 was solid.
- We expect Barcelona to gradually improve its budgetary performance and stabilize its debt over 2021-2023.
- We have therefore affirmed our 'A' long-term issuer credit rating on Barcelona.
- The negative outlook reflects the outlook on the sovereign, since we do not believe Barcelona meets the conditions to be rated above Spain.

PRIMARY CREDIT ANALYST

Alejandro Rodriguez Anglada
Madrid
+ 34 91 788 7233
alejandro.rodriguez.anglada
@spglobal.com

SECONDARY CONTACT

Mariamena Ruggiero
Milan
+ 390272111262
mariamena.ruggiero
@spglobal.com

Rating Action

On July 23, 2021, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on Spain's City of Barcelona. The outlook is negative.

Outlook

The rating on Barcelona is capped by the ratings on Spain (A/Negative/A-1). Therefore, the negative outlook on Barcelona reflects that on Spain.

Downside scenario

If we were to downgrade Spain in the next 18 months, we would downgrade Barcelona.

Upside scenario

We would revise the outlook to stable over the next 18 months, all else being equal, if we revised our outlook on Spain to stable.

Rationale

The rating on Barcelona reflects primarily that on the sovereign. The links between Spain and Barcelona do not allow us to rate Barcelona above the sovereign, as is the case for all Spanish cities.

Barcelona's creditworthiness is characterized by a rather supportive institutional framework that has prompted Spanish local governments to post balanced accounts in previous years. Strong financial management also supports the rating, and has kept the city's performance sound in recent years by imposing financial thresholds, for instance on debt, that are more stringent than the national ones. Barcelona's financial management has increased expenditure to deal with the consequences of the pandemic, and was able to accomplish this while maintaining a sound budgetary performance and slowing the city's debt accumulation. The city also maintains comfortable liquidity that amply covers its debt-service requirements.

We assess Barcelona's stand-alone credit profile (SACP) at 'aa-'. The SACP is a way to assess the intrinsic creditworthiness of a local or regional government under the assumption that the rating on the sovereign is not a constraint.

Revenue stability and prudent financial management should allow a recovery of budgetary performance

The pandemic has not had a meaningful impact on Barcelona's revenue, due to the relative stability and predictability of most of its revenue sources. We believe this is a structural feature of local governments in Spain.

Central government transfers, the so-called Fondo Complementario de Financiación, represent about 40% of Barcelona's operating revenue. For 2020 and 2021, the central government decided to provide cities with higher transfers than national economic performance would suggest. For example, central government transfers increased by 5.5% in 2020 versus 2019, despite an estimated nominal national GDP decline of 10.9%. In our view, the Spanish government has done this to soften the impact of the pandemic on local governments' finances.

However, excess transfers will generate negative settlements that are to be returned to the central government from 2022. We assume the central government will allow these returns to be spread over several years, following the precedent of a similar situation in 2008 and 2009. As such, we expect the impact on the city's budgetary performance will be limited. We view this as evidence of the supportive nature of the institutional framework for local governments in Spain.

Because of the pandemic's impact, the central government suspended fiscal rules temporarily, allowing local governments to post deficits in 2020 and 2021. We understand the city's financial management intends to use this leeway to boost investments in 2021 to support the local economy.

In our view, Barcelona's financial management displays a strong commitment to budgetary discipline and reining in debt. Barcelona's economy has suffered from the impact of the pandemic, due to the importance of its tourism sector. However, we expect the city's economy will recover in line with our expectation for the national economy, as restrictions on mobility and economic activity are phased out.

Despite a temporary weakening of operating balances, we expect the budget to remain balanced

We forecast Barcelona's operating margins will average about 14% of operating revenue over 2021-2023, which is better than our previous estimate of 12% over the same period. We expect the city to maintain high operating expenditure, particularly related to social services, but with operating margins gradually increasing toward its internal target of 15% of operating revenue, which it temporarily suspended due to the pandemic.

Barcelona posted a small deficit for 2020 in national accounting terms, but a small surplus in budgetary terms. The difference between the two is related to a temporary decrease in cash collection of some revenue items because of the pandemic, as well as the one-off effect of changes in accounting for some revenue items.

We have revised our budgetary forecasts in light of Barcelona's stronger performance in 2020 compared with our previous forecasts, and the stronger prospects for economic recovery. We consequently now estimate that the city can maintain balanced budgets in budgetary terms throughout our forecast period, instead of the small deficits we previously estimated.

Although we expect the city to increase investments to support the local economy and contribute to the recovery, we believe its financial management will moderate investment execution to allow for a gradual improvement in budgetary outcomes. However, our forecast remains subject to uncertainty regarding the central government's decision on whether to suspend fiscal rules for 2022. If this were the case, the city might decide to use the additional leeway to bring forward certain investments or execute on existing commitments, thereby freeing up budgetary space for future years.

We understand the city remains committed to its plan to invest in housing units through its municipal housing company. The city's housing operator--Instituto Municipal de la Vivienda y Rehabilitación de Barcelona--continues to implement its major project, which entails the construction of about 180,000 square meters of housing units, mostly destined for social rentals. The plan is estimated to cost up to €365 million, and is the main reason for our forecasts of debt accumulation. Since we anticipate broadly balanced budgets, we expect Barcelona's direct debt will remain fairly stable in nominal terms over our forecast period through 2023.

Barcelona's tax-supported debt should reach about 39% of consolidated operating revenue by 2023, below our previous estimate of 45%. This, in our view, indicates a very low debt burden in a Spanish and international context, especially taking into account the city's ability to generate recurring operating balances.

We expect Barcelona's liquidity will remain very strong in 2021 and 2022. Our debt-service coverage ratio, which compares available liquidity sources with debt service, remains well above 100% through our forecast period, and we don't foresee Barcelona needing to resort to short-term credit lines or similar instruments. In our view, Barcelona's management seeks to maintain sufficient liquidity buffers. The city defines its treasury plans based on very conservative assumptions, which often translate into lower borrowing than initially planned in the budget. The city actively manages its liquidity and maintains the period of payment to suppliers constantly below 30 days.

We cap our long-term rating on Barcelona at the long-term rating on Spain. In our view, the city does not meet the criteria under which we would rate it higher than the related sovereign. We believe Barcelona lacks sufficient financial autonomy to effectively resist significant sovereign intervention, such as reductions or delays in central government transfers. We do not believe that

Research Update: Spanish City of Barcelona 'A' Rating Affirmed; Outlook Still Negative

Barcelona's credit quality could withstand the stress of a sovereign default, given its reliance on central government transfers and tax transfers (for about 40% of operating revenue). Like all Spanish cities, Barcelona has no substantial legislative power over its budgetary and financial framework.

Key Statistics

Table 1

City of Barcelona--Selected Indicators

Mil. €	--Fiscal year end Dec. 31--					
	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenues	2,806	2,864	2,918	3,012	3,123	3,200
Operating expenditures	2,363	2,351	2,489	2,593	2,673	2,734
Operating balance	443	513	429	419	450	466
Operating balance (% of operating revenues)	15.8	17.9	14.7	13.9	14.4	14.6
Capital revenues	52	29	21	50	65	70
Capital expenditures	452	447	343	455	495	505
Balance after capital accounts	43	95	108	14	20	31
Balance after capital accounts (% of total revenues)	1.5	3.3	3.7	0.5	0.6	1.0
Debt repaid	49	56	83	93	94	65
Gross borrowings	49	0	102	110	94	65
Balance after borrowings	43	40	126	31	20	31
Direct debt (outstanding at year-end)	836	780	800	817	817	817
Direct debt (% of operating revenues)	29.8	27.2	27.4	27.1	26.1	25.5
Tax-supported debt (outstanding at year-end)	982	949	969	1,049	1,133	1,235
Tax-supported debt (% of consolidated operating revenues)	34.5	32.6	32.7	34.3	35.8	38.1
Interest (% of operating revenues)	0.5	0.4	0.4	0.4	0.4	0.4
Local GDP per capita (€)	30,947	31,561	N/A	N/A	N/A	N/A
National GDP per capita (€)	25,810	26,520	23,698	25,567	27,628	28,885

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable.

Ratings Score Snapshot

City of Barcelona--Ratings Score Snapshot

Table 2

Key rating factors	Scores
Institutional framework	3
Economy	2
Financial management	2
Budgetary performance	1
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa-
Issuer credit rating	A

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 12, 2021. An interactive version is available at <http://www.spratratings.com/sri>

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, June 4, 2021
- Barcelona (City of), March 1, 2021
- City of Barcelona Outlook Revised To Negative After Similar Action On Spain; 'A' Rating Affirmed, Sept. 22, 2020

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the

Research Update: Spanish City of Barcelona 'A' Rating Affirmed; Outlook Still Negative

appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Barcelona (City of)

Issuer Credit Rating A/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.